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SUBJECT: The Japan Economic Scope - March 2, 2007

Sensitive but unclassified. Please protect accordingly.

[1](#)1. (SBU) Table of Contents

[1](#)2. (U) This cable contains the Japan Economic Scope from February 23, 2007.

[1](#)3. Upper House Member Running for Reelection Predicts Win for DPJ

[1](#)4. Russian PM Fradkov Visits Japan

[1](#)5. MAFF Sounds the Alarms About Free Trade

[1](#)6. An Intelligent Diet Debate on Beef

[1](#)7. Sakhalin 2 All Sold Out

[1](#)8. Tokyo Stocks Mark Largest Drop in Eight Months, End at Three-Week Low

[1](#)9. Recent Major Economic Indicators

[1](#)10. Toyota's U.S. Presence

[1](#)11. Toyota's Consolation Prize Is Not Bad

[1](#)12. The New Regulatory Reform Council Sprints Ahead

[1](#)13. Asian Copyright Seminar in Tokyo

[1](#)14. Beyond the Kyoto Protocol--Kawaguchi Speaks Out on Global Warming

[1](#)15. Possible Movement by MHLW on MRL Sanctions Issue

[1](#)16. PM Bowing to Ag Lobby Before Opening EPA Talks with 17. Farm Lobby Satisfied with Australia Visit

[1](#)17. FDI: AMB Property to Expand Operations in Fukuoka

[1](#)18. Special Zones -- Running Out of Ideas?

[1](#)19. Chrysler Japan's Position Shifting on Exchange Rates

[1](#)20. Matsuzaka Set to Launch Red Sox Career in Exhibition Game Against Boston College

[1](#)21. Hokkaido Explores New Ways To Sell Air Tickets

[1](#)22. Miyagi Whaling Town Expands Whale Meat School Lunches to Pre-Schoolers

[1](#)3. (SBU) Upper House Member Running for Reelection Predicts Win for DPJ  
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EMIN met on February 26 with DPJ member Hideki Wakabayashi and broadly discussed the July 2007 election outlook and DPJ policy priorities. Up for reelection himself, Wakabayashi said he has been campaigning flat out nationwide since the beginning of the year with most of his early mornings spent standing outside factory gates seeking blue collar votes.

He described the election as the DPJ's to lose and forecast the

increasing likelihood that the LDP in desperation will call for a double, lower house and upper house election. Wakabayashi portrayed PM Abe as a good man, but altogether "too normal" for the challenges facing Japan, especially the structural problems of a massive public sector debt combined with a shrinking, aging population.

Abe's loss of popularity is due the Japanese public's perception that he lacks the necessary leadership skills, said Wakabayashi, and forecast the PM's support will take a further significant hit as the result of his recent decision to readmit another postal rebel back into the LDP.

On international economic policy, Wakabayashi said the GOJ's ASEAN+6 proposal is a mistake. He argued that if Japan is to support further economic integration in Asia, it should ensure that the United States is part of that effort.

#### 14. (U) Russian PM Fradkov Visits Japan -----

Russian Prime Minister Fradkov and Minister of Industry and Energy Khristenko visited Japan this week along with over 200 representatives from Russian industry to participate in the Japan-Russia Investment Forum and in high-level official and private sector meetings.

PM Fradkov's mission is to boost economic ties between the two countries in business, energy, trade and investment, particularly in the Russian Far East, while the GOJ hopes to lay the groundwork leading to a resolution in the dispute over the Northern Islands. The two governments and their respective industries have agreed to closer relationships and signed several

TOKYO 00000910 002 OF 008

MOUs and other documents.

While the GOJ is enthusiastic about improved ties to Russia, Japanese industry has taken a "wait and see" attitude. The Russian Government's involvement in the Sakhalin oil and gas projects is still a vivid memory for many.

The uncertainty surrounding the Russian investment climate is another reason for the passive approach of Japanese industry.

#### 15. (SBU) MAFF Sounds the Alarms About Free Trade -----

Japan's Agriculture Ministry is not making it any easier for Prime Minister Abe to fulfill his ambitions to reach a multilateral Doha trade deal or even bilateral deal with Australia.

At a working group session of the Prime Minister's Council on Economic and Fiscal Policy (CEFP) on February 26, the Ministry delivered a gloomy assessment of what would happen if agricultural tariffs were eliminated.

According to the MAFF estimates, Japanese farmers would suffer 9 trillion yen in losses if tariffs were eliminated, or 1.8 percent of GDP.

MAFF's static analysis only looks at the downside. At present, Japanese spend up to 17 percent of their income on food, compared to 10 percent in Europe and 6 percent in the United States. Economists agree that Japan's GDP would benefit in the long run from the stimulus that would accrue if consumers could spend less money on food and more on other things. Moreover, less protectionism would force farmers to restructure and become more competitive.

Two experts we have talked to in recent weeks connected with the CEFP are well aware of the bias found at MAFF. Maybe a little "gaiatsu," or foreign pressure, would be merited to help take on Japan's farm special interests, one told us.

#### 16. (U) An Intelligent Diet Debate on Beef

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A Diet Member from Hyogo Prefecture had some common sense questions about the BSE scare during a lower house budget debate March 1. Kazuyoshi Akaba, of the Komeitoo Party, part of the ruling coalition, pressed Health Ministry officials during a subcommittee meeting about the efficacy of blanket testing for BSE of all cows. In particular he wanted to know if the government would continue to fund testing for cows under 30 months old when the science is suggesting it is not merited. For the first time, an MHLW official acknowledged that there was "no transmissibility" when pressed by Akaba on some problematic BSE tests that had produced some dubious positive findings on two 20-21 month old cows. Health Ministry Director General Fujisaki said, however, that follow up testing is continuing. Akaba criticized what he called "fuzzy research" and suggested the testing should not be allowed to continue forever.

"Blanket testing does not catch all infected animals," Akaba said, echoing what the United States has been telling GOJ authorities for months. "It is the SRM removal that assures safety of beef, not testing," he continued. "This is the internationally recognized science."

He concluded his remarks during the budget session by saying it was time that the government "started educating the public about the truth." Akaba is a five-term Diet Member who previously worked for Mitsui Trading Company. For an unofficial Embassy transcript of the exchange, see attachment.

#### 17. (U) Sakhalin 2 All Sold Out

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Developers of the Sakhalin 2 project have completed contracts to sell all of its expected liquefied natural gas (LNG) production. Of the eleven companies that have signed these long-term contracts, nine are Japanese. They include Tokyo Electric Power Company (TEPCO) - 1.5 million tons, Tokyo Gas - 1.1 million tons,

TOKYO 00000910 003 OF 008

Kyushu Electric Power, Inc. - 500,000 tons, Toho Gas (Nagoya) - 500,000 tons, Chubu Electric Power Co., Inc. - 500,000 tons, Tohoku Electric Power - 420,000 tons, Hiroshima Gas - 210,000 tons, Osaka Gas - 200,000 tons, and Saibu Gas (northern Kyushu) - 8,500 tons.

The two non-Japanese companies are Shell Eastern Trading, which contracted for 1.8 million tons, and KOGAS, a Korean state-owned company and the world's largest importer of LNG, which contracted for 1.5 million tons.

#### 18. (U) Tokyo Stocks Mark Largest Drop in Eight Months, End at Three-Week Low

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Tokyo stock prices tumbled Wednesday, dragging down the benchmark Nikkei-225 Stock Average more than 500 points to almost a three-week low, as a plunge in US stock prices unnerved investors. The Nikkei Stock Average slid 516 points, or 2.8%, to close at 17,604.12, its largest one-day loss in eight months and lowest close since February 9. On February 26, the Nikkei Stock Average registered a six-year, nine-month high (since May 2000). Despite the today's loss, the Nikkei Stock Average is still 3,385 points or about 23.8% higher than the recent trough of June 13, 2006. Please see attached document for more details.

#### 19. (U) Recent Major Economic Indicators

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The Cabinet Office left unchanged its overall economic assessment for the third month in a row, noting that the economy is recovering, despite some weakness in consumption. The monthly economic report, submitted to the Cabinet on February 19, confirmed that Japan's economy has expanded 61 straight

months, a postwar record. The report said that corporate profits and capital investment are up, but private consumption is almost flat.

The BOJ report, released February 21, also left unchanged its core economic assessment, indicating that the economy is "expanding moderately." The BOJ indicated that personal consumption has been firm, reflecting a modest rise in household income.

As for the outlook, the BOJ expects the economy to continue to expand moderately. Please see attached document for more details.

¶10. (U) Toyota's U.S. Presence  
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Not least due to this week's announcement of Toyota's new Highlander plant in Mississippi, scheduled to begin production in 2010 (see attached press release for details), increasing interest has focused on Toyota's U.S. presence. A quick guide: Staff -- Toyota had about 35,000 direct hire factory and corporate employees in the U.S. at the end of 2006. This compares to 65,000 direct hire employees in Japan. U.S. Staff of Toyota dealerships and other "indirect workers" total an additional 110,000, and Toyota Tier One suppliers' staff in America was a further 51,000 at the end of 2004. In total, the Center for Automotive Research in Michigan estimates current Toyota-dependent jobs in the U.S. add up to as many as 380,000. Vehicles -- In calendar 2006, Toyota sold 2.54 million vehicles in the U.S. Of those, 1.36 million, or about 53.5 percent, were produced in North America (including production from plants in Canada and Mexico, although the lion's share was made in the United States). The remaining 1.18 million were produced in Japan. See attached press release for more information.

¶11. (SBU) Toyota's Consolation Prize Is Not Bad  
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Hot on the heels of announcing its new \$1.3 billion SUV factory in Mississippi (see above) Toyota announced on February 28 that it will spend 3.3 billion yen (about \$29 million) to build an R&D center for its NASCAR team near Charlotte, North Carolina, to open in late 2008. North Carolina was originally in the running for the SUV plant, and is not currently home to a Toyota-owned factory.

TOKYO 00000910 004 OF 008

At a February 26 meeting with Principal Officer, the Managing Officer in charge of Toyota's America's Division made clear Toyota understands the political value of spreading its major facilities among a number of states.

¶12. (U) The New Regulatory Reform Council Sprints Ahead  
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The new Council on the Promotion of Regulatory Reform met on Feb. 23 to get things off the ground by setting up working groups and deciding on its priorities. The Council pledged to sprint through until the end of May when the mid-term report is due, and identified seven priority issues for the initial period, naming them "Dash Seven".

The Council's focus for the next three months includes the following: promoting the use of IT in medical areas (e.g., online medical receipts); reviewing obstacles for the promotion of regional industrialization and tourism; abolishing/reducing the operations of Independent Administrative Agencies; establishing review periods for regulations, publicly announcing binding notifications; and reforming the operations of port, aviation, and distribution systems (i.e., expanding the capacity of aviation traffic in the Tokyo metropolitan area, improving airport operation, reforming customs procedures, etc.) Agriculture, however, was not included in the seven sectors, but has been listed as one of the issues that should be included in its final report in December. The reason, according to reports,

is probably because the issue is too sensitive to be discussed in view of the Upper House election in July, in which farm votes could hold the key.

The council has listed two agendas for agricultural issues: 1) enhancing farm size and promoting new entry 2) resolution of issues that prevent farming from being more efficient. The Japan Agriculture News indicates that farmland reform and JA reform, both issues that were discussed under the previous organization should also continue to be considered.

The Council will also follow-up on the proposals from its predecessor body in education, broadcasting and telecommunication areas and, over the longer term, will address sectoral issues including medicine, finance, competition policy, IT, energy, transportation and labor.

13. (U) Asian Copyright Seminar in Tokyo  
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"Awareness building" was the focus of the 10th annual Asian Copyright Seminar February 28-March 1 in Tokyo. Sponsored by the GOJ Agency for Cultural Affairs and Copyright Research and Information Center, the event included presentations by representatives from 11 Asian countries on the status of copyright protection and enforcement challenges.

Also on hand, Pedro Velasco Martins, Principal Administrator at the European Commission, spoke about general IPR infringements issues, underscoring the negative consequences of IPR violations. He surveyed ongoing EU efforts to increase IPR awareness in ASEAN, including providing funding on capacity building of ASEAN institutions.

The U.S. Patent and Trademark Office official scheduled to participate could not attend.

14. (U) Beyond the Kyoto Protocol--Kawaguchi Speaks Out on Global Warming  
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Former Foreign Minister and Environment Minister Yoriko Kawaguchi spoke at LDP headquarters on February 20 to an audience of Japanese citizens and foreign diplomats about global warming. Kawaguchi outlined her views on a successor framework to the Kyoto Protocol, emphasizing the importance of international cooperation and communication needed to establish it. The new framework first should be something in which all major countries join. Second, it should lead to a mandatory agreement on reducing greenhouse emissions and, third, it should be sustainable for the long term.

TOKYO 00000910 005 OF 008

Kawaguchi argued in favor of flexibility from current members of the Kyoto Protocol toward the United States, China and other non-members to encourage their participation in the next framework. She observed, however, that her experience working on the Kyoto Protocol had taught her that coming to any agreement will be time-consuming and difficult.

Kawaguchi was very blunt in her assessment of Japan's ability to reduce its emissions by six percent from the 1990 level, especially since its emissions have increased by eight percent since 2005. She cited delays in nuclear power plant construction as one of the reasons and agreed that corporations needed more motivation to reduce gas emission.

She also called for increasing the transfer of related technology to other countries, including China, arguing that innovation and the spread of technology are key to reducing CO2, and noting that the situation in neighboring countries affects Japan. Kawaguchi stressed that emissions trading should function as a market mechanism and praised the Clean Development Mechanism, a method allowing industrialized countries to invest in emission-reducing projects in developing countries as an alternative to

reducing their own "often more costly" emissions.

Kawaguchi drew a link to global warming and poverty, highlighting her concern that climate change would increase difficulties in African countries and other poor nations currently suffering from extended drought and other unpredictable weather conditions. She also stressed its link to fiscal and financial problems, citing as an example the cost of Hurricane Katrina, which was the equivalent of 10 percent of the GOJ budget.

¶15. (U) Possible Movement by MHLW on MRL Sanctions Issue  
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As a follow up to the Maximum Residue Level (MRL) issue being discussed in the Regulatory Reform Initiative, MHLW indicated a willingness to work toward an understanding that might address the concerns of the United States if the United States would refrain from taking its complaints to the WTO SPS Committee. The U.S. side agreed not to raise the issue yet in the SPS Committee based on this signal from Japan to give the discussions time to work. There is some difference of opinion among the U.S. industry about exactly what changes are needed from Japan and so the U.S. is still trying to determine its negotiating position. Japan has said it needs to review the U.S. system for regulating pesticide and animal drug use as a basis for moving forward, and this step is already underway.

¶16. PM Bowing to Ag Lobby Before Opening EPA Talks with Australia?  
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Prime Minister Abe hinted during a Diet Budget Committee hearing March 1 that any Economic Partnership Agreement struck with Australia would have to take into account the concerns of Japan's protectionist farm lobby. "Japan must protect what must be protected," he said obliquely.

Separately, according to press reports, the head of the LDP's Policy Research Council, Shoichi Nakagawa, threw his support in with the farm lobby, saying he favors excluding sensitive agricultural products from any EPA with Australia. With previous stints as Trade Minister and Agriculture Minister, Nakagawa's views on these issues enjoy enormous weight in the Diet.

Meanwhile, Foreign Minister Aso, according to the Japan Agricultural News, stated similar views on an EPA with Australia in the Diet on February 28.

Australian Prime Minister John Howard is due to visit Japan later this month. The Australians have so far maintained a position that they want sensitive items to remain on the table.

¶17. Farm Lobby Satisfied with Australia Visit  
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An official from Japan Agriculture, the protectionist lobbying group for Japan's small farmers, told us February 27 that JA's

TOKYO 00000910 006 OF 008

visit to Australia the previous week went well. They were able to explain their views to Australian government officials and to the Australian Farmers Federation.

The JA official did not want to predict for us when Japan and Australia would begin negotiations on an Economic Partnership Agreement. He indicated that much would depend on whether full blown Doha Round negotiations would get going in coming weeks. He doubted that full fledged EPA talks could run concurrently. Absent resumed Doha negotiations, the JA official suggested that unofficial, working level EPA talks with Australia could start as early as April. This is not a timeframe we have heard from the concerned ministries.

JA plans a series of seminars throughout Japan in March updating its members on the current state of play concerning EPA negotiations with Australia, and also with a view to developing a



firm consensus on the subject.

¶18. FDI: AMB Property to Expand Operations in Fukuoka  
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AMB Property Corporation, a San Francisco-based global developer and owner of industrial real estate, told AmCon Fukuoka that Fukuoka is the next target for their business expansion strategy in Japan.

As the world's largest owner of airport-related distribution facilities, the firm has already established operations in the Tokyo, Osaka and Nagoya areas. According to company officials, AMB has been developing a business plan for Fukuoka operations for over a year, centering on facilities near Fukuoka Airport and Hakata Port.

In addition, AMB officials stressed that Fukuoka's close geographical proximity to neighboring Asian countries gives the city a competitive edge in building an efficient distribution network linking Asia to other parts of Japan. AMB headquarters officials visited Fukuoka on February 27-28 on a JETRO-funded FDI promotion program organized by Fukuoka City. AMB intends to set up operations in Fukuoka at the earliest possible time, eying its rival Denver-based ProLogis' business activities in this region, including the \$85million project now under construction in neighboring Saga Prefecture.

¶19. (U) Special Zones -- Running Out of Ideas?  
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Only one proposal made the list for deregulatory measures in the latest round of proposals for Special Zones, an initiative launched by the previous Prime Minister to stimulate regulatory reform. The number of approvals hit the lowest record since its inception in 2003. The approved measure will relax the requirement to screw on temporary license plates on cars in transport. A port in Miyagi Prefecture will likely adopt this measure.

Although the Diet will consider a bill to extend the initiative for five more years, it is still unclear how it will be revived to make it more attractive and draw more applications. The initiative is intended to offer a trial ground for deregulatory measures in a geographically specific area, with an eye to extend them nationwide.

However, some local entities have insisted that not all measures should become nationwide (e.g., "Doburoku Tokku" whereby local inns are allowed to brew their own sake). Allowing nationwide application of such measures would take away the "competitive edge" for tourism in these towns, they argued.

Furthermore, approved measures have sometimes been so limited for them to be of any use (e.g., medical Tokku allowing mixed-treatment). Ministries tend to be on guard when negotiating a regulatory exemption since they have to assume that such an exemption will be applied nationwide in a couple of years. The application system also remains cumbersome. The Secretariat for Special Zones has made an effort to reach out by sending its staff and Ministry officials to local areas and offering briefings and consultations. However, the declining trend in the number of proposals indicates that it may be difficult to

TOKYO 00000910 007 OF 008

resuscitate Koizumi's brainchild.

¶20. (SBU) Chrysler Japan's Position Shifting on Exchange Rates  
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In a discussion with Chrysler Japan on March 2, a Chrysler official told us the company is becoming increasingly concerned about the over-valued yen now that the European carmakers, including the Daimler part of the organization, have started to make this an issue.

121. (U) Matsuzaka Set to Launch Red Sox Career in Exhibition  
Game Against Boston College  
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Matsuzaka Mania continues in Japan. With the star Japan right hander set to pitch his first exhibition game for the Boston Red Sox on March 1 in Ft. Myers, Florida, the game will be broadcast live on NHK at 7:30 am on Saturday morning. Hundreds of Japanese reporters have been following him around since his arrival at the Red Sox spring training camp in Florida.

Matsuzaka is a formidable addition to an already talented Red Sox starting rotation, which makes Boston odds on favorite to win the World Series in 2007. He is joined on the Red Sox by Hideki Okajima, a savvy left hander with a sharp curve ball who pitched last year for the Japan Series Champions Hokkaido Ham Fighters.

122. (U) Hokkaido Explores New Ways To Sell Air Tickets  
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Hokkaido District Transport Bureau officials recently announced with JAL, ANA, Hokkaido Air System and Airtransse, the creation of Japan's first "circular air ticket" system.

Scheduled to go on sale in the summer of 2007, the "Hokkaido Circular Ticket" packet will sell for 30,000 yen (\$250) and include three air tickets valid for travel on any participating airline's flights to local Hokkaido airports only as well as a coupon for a one night stay at a local hotel. The ticket packets will be valid for two months, and all tickets in the packet must be used within 14 days of the date that the first ticket is used. Travelers who use the circular air ticket packet could save as much as 50 percent of standard travel costs.

The experimental circular air ticket program hopes to increase air travel and tourism within Hokkaido on existing flights.

123. (U) JAL to Save on Fuel Costs in One World Alliance  
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In a March 1 press conference, JAL President Haruka Nishimatsu and One World Alliance chiefs discussed the benefits of the One World Alliance.

Importantly, JAL's joining the Alliance on April 1 will allow the company to reduce its fuel costs by jointly purchasing fuel with other alliance members. In addition, JAL will receive help from alliance members in selling seats.

The One World alliance airlines also met with MLIT Minister Tetsuzo Fuyushiba to express support for GOJ "Visit Japan Campaign" to double the number of travelers to Japan.

124. (U) Miyagi Whaling Town Expands Whale Meat School Lunches to  
Pre-Schoolers  
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As part of efforts to educate youth about whaling, Inshinomaki in Miyagi Prefecture decided recently to expand the number of schools that serve whale meat beyond all elementary and middle schools to also include all local nursery schools.

Previously, only the Ishinomaki ward of Oshika, a traditional whaling community that hosts the annual Oshika Whale Festival, regularly included whale meat on the school lunch menus for all students, pre-school through middle school. After Oshika was incorporated into Ishinomaki's city limits in 2005, however, education officials began considering how to expand Oshika's

TOKYO 00000910 008 OF 008

whale lunch program to other schools in the city.

Post's contact at the Ishinomaki Board of Education explained that in addition to celebrating the region's whaling history, the expanded school lunch program is also part of a larger effort to



promote local consumption of local products. He admitted, however, that Ishinomaki purchases whale meat from the Government of Japan affiliated whale meat wholesaler at a special school lunch price to make the normally expensive commodity more affordable.

SCHIEFFER